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DEPARTMENT FOR EB/IFD/OIA, EUR/NB
DEPARTMENT PLEASE PASS USTR FOR JKALLMER AND OPIC
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TAGS: [ECON](#) [EFIN](#) [ELAB](#) [ETRD](#) [KTDB](#) [EINV](#) [OPIC](#)
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SUBJECT: 2009 INVESTMENT CLIMATE STATEMENT - ESTONIA

REF: 08 STATE 00123907

11. (U) The following is the 2009 Investment Climate Statement for Estonia, keyed to questions in reftel.
12. (U) A.1. Openness to Foreign Investment

Since joining the EU in 2004, the Estonian government has sought to maintain liberal policies in order to attract investments that could produce exports. Foreign investors are treated on an equal footing with local investors. While the GOE's focus in the mid-1990s was to attract actively foreign direct investment (FDI) into Estonia, at present it is prioritizing the finding of new export markets for Estonian goods and services. Creating favorable conditions for FDI and openness to foreign trade has been the foundation of Estonia's economic strategy.

Estonia's government does not screen foreign investments. It does, however, establish requirements for certain sectors. These requirements are not intended to restrict foreign ownership but rather to regulate it and establish clear ownership responsibilities. Licenses are required for a foreign investor to become involved in the following sectors: mining, energy, gas and water supply, railroad and transport, waterways, ports, dams and other water-related structures and telecommunications and communication networks. The Estonian Central Bank issues licenses for foreign interests seeking to invest in or establish a bank. Government review and licensing have proven to be routine and non-discriminatory.

Estonia's openness to foreign direct investment extended to its 1993-2001 privatization program, which is now complete. Only a small number of enterprises -- the country's main port, the power plants, the postal system, and the national lottery -- remain state-owned. In January 2007, the government also repurchased the 66 percent of shares of the Estonian Railway which had been in the hands of private investors since 2001, claiming the need to maintain control of this key part of Estonia's national infrastructure.

During the last decade, Estonia has been one of the

leading countries in Central and Eastern Europe in terms of inward investment per capita. Companies partly or wholly owned by foreigners account for one-third of Estonian GDP and over 50 percent of the country's exports. Some general facts concerning foreign direct investment inflows into Estonia include:

- In 1995-1996, the majority of foreign direct investment was privatization-related;
- There is a trend towards cross-border acquisitions;
- Greenfield investments are increasingly rare;

A.2. Conversion and Transfer Policies

Estonia has been under a currency board arrangement since 1992. Initially pegged to the German mark, the Estonian kroon (EEK) has been fixed to the euro at EEK 15.65 since January 1999. Estonia joined the Exchange Rate Mechanism (ERM) II in June, 2004.

The Estonian currency has no restrictions on its transfer or conversion. Similarly, there are no restrictions, limitations or delays involved in converting or transferring funds associated with an investment (including remittances of investment capital, earnings, loan repayments, or lease payments) into other currencies at market rates. There is no limit on dividend distributions as long as they correspond to a company's official earnings records. If a foreign company ceases to operate in Estonia, all its assets may be repatriated without restriction. These policies are all long-standing; there is no indication that they will be altered in the future. Foreign exchange is readily available for any purpose.

A.3. Expropriation and Compensation

Private property rights are observed in Estonia. The government has the right to expropriate in the case of public interests related to border guard, public ports and airports, public streets and roads, supply to public water catchments, etc. Compensation is offered based on market value. Post is not aware of any expropriation cases involving discrimination against foreign owners.

A.4. Dispute Settlement

Investment disputes concerning U.S. or other foreign investors and Estonia are rare. Estonia's judiciary is independent and insulated from government influence. Property rights and contracts are enforced by the courts.

Estonia's commercial law has proven extremely effective and is often cited as one of the components of Estonia's successful economic reforms. The Commercial Code, as a part of the overall commercial law, is consistently applied. The Obligation Law, enacted in 2002, is the basis for all commercial agreements. A Bankruptcy Act was adopted in 2004. The full text of these laws can be found from: <http://www.legaltext.ee/en/> Estonia has been a member of the International Center for the Settlement of Investment Disputes (ICSID) since 1992, and a member of the New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards since 1993.

Recognition of court rulings of EU Member States is regulated by EU legislation.

The Arbitration Court of the Estonian Chamber of Commerce and Industry is a permanent arbitration court which settles disputes arising from

contractual and other civil law relationships, including foreign trade and other international economic relations.

A.5. Performance Requirements/Incentives

A fundamental principle of Estonia's economic policy is equal treatment of foreign and domestic capital. No special investment incentives are available to foreign investors, nor is any favored treatment accorded them. Similarly, there are no specific performance requirements for foreign investments that differ from those required of domestic investments.

Estonia continues to refine its immigration policies and practices. U.S. citizens are exempt from the quota regulating the number of immigration and residence permits issued, as are citizens of the EU and Switzerland.

Estonia's has a long-standing system of low, simple, flat-rate taxes, in particular, a 21 percent income tax which is set to be reduced one percent per year until it reaches 18 percent in 2012. To encourage companies to expand their business, all reinvested profits are exempted from corporate income tax. However, any redistributed profits, such as dividends, are taxed at 21 percent in 2009. This tax strategy was designed to promote business and accelerate economic growth by making additional funds available for investment. During accession talks, the EU gave Estonia a transition period of seven years (the end of 2008) by which time this tax policy will have to be brought into accordance with EU tax directives governing parent-daughter subsidiary relationships. Starting in January 2009, undistributed corporate profits will remain tax-exempt and the tax base for corporations will generally remain the same, except that liquidation proceeds, share buy-backs and capital reductions will become subject to tax at the level of Estonian company, just as dividends are taxed. (Previously, such items were taxable at the level of the shareholder.)

Generally, the government does not impose 'offset' requirements on major procurements. There are no government imposed conditions to invest.

A.6. Right to Private Ownership and Establishment

Private ownership and entrepreneurship are respected in Estonia. In most fields of business, participation by foreign companies or individuals is unrestricted. As provided for by the Law on Foreign Investments, foreign investors have the same rights and obligations as Estonian citizens. Foreign investors may purchase buildings and land for production purposes and establish, buy, and fully own companies.

Government approval is required for foreign investment and participation in only a handful of sectors (see section A.1).

Competitive equality is the official standard applied to private enterprises in competition with public enterprises. Private companies do not face discrimination in relation to state-owned companies.

Estonia made amendments to the Regulation on Rules of Takeover Bids taking into the consideration Directive 2004/25/EC of the European Parliament and new amendments came into force February 8, 2008.

A.7. Protection of Property Rights

Secured interests in property are recognized and

enforced. Mortgages are quite common for both residential and commercial property and leasing as a means of financing is widespread and efficient.

The legal system protects and facilitates acquisition and disposition of all property rights, including land, buildings, and mortgages. The long and complicated process of property restitution (begun when the Principles of Ownership Reform Act came into force June 20, 1991) is almost complete, including the area of non-residential real properties.

The Estonian legal system adequately protects property rights, including intellectual property, patents, copyrights, trademarks, trade secrets and industrial design. Estonia adheres to the Berne Convention, WIPO and TRIPS, the Rome Convention and the Geneva Convention on the Protection of the Rights of Producers. Estonian legislation fully complies with EU directives granting protection to authors, performing artists, record producers, and broadcasting organizations.

A.8. Transparency of the Regulatory System

The Government has set out transparent policies and effective laws to foster competition and establish "clear rules of the game." However, due to the small size of Estonia's commercial community, instances of favoritism are not uncommon despite regulations and procedures designed to limit them.

Tax, labor, health and safety laws and policies have been crafted to encourage investment. They appear to have been successful, given the relatively high level of foreign direct investment per capita.

All proposed laws and regulations are published for public comments on the website:
<http://eoigus.just.ee/>
There is also website www.osale.ee where the public can comment on draft laws and propose changes to the government regulations.

Estonia's bureaucratic procedures are generally far more streamlined and transparent than those of other countries in the region.

International institutions and organizations give Estonia's economic policies high marks. The U.S.-based Wall Street Journal/Heritage Foundation's 2008 Index of Economic Freedom ranked Estonia 12th in the world. The index is a composite of scores in monetary policy, banking and finance, black markets, wages and prices. Estonia scores highly on this scale for investment freedom, fiscal freedom, financial freedom, property rights, business freedom, and monetary freedom.

A.9. Efficient Capital Markets and Portfolio Investment

Estonia's financial sector is modern and efficient. Government and Central Bank policies facilitate the free flow of financial resources, thereby supporting the flow of resources in the product and factor markets. Credit is allocated on market terms and foreign investors are able to obtain credit on the local market. The private sector has access to an expanding range of credit instruments similar in variety to those offered by banks in Estonia's Nordic neighbors Finland and Sweden.

Legal, regulatory, and accounting systems are transparent and consistent with international norms.

The Security Market Law complies with EU requirements and enables EU securities brokerage

firms to deal in the market without establishing a local subsidiary. In 2002, the Helsinki Stock Exchange (Finland) bought a controlling interest in the Tallinn Stock Exchange, merging the two entities and making the smaller Estonian market more accessible to foreign investors.

Estonia's banking system has consolidated rapidly. Total assets of the commercial banks are approximately USD 31 billion at the end of 2008. Two Swedish-owned banks (Swedbank and SEB) control over 70 percent of the market. More info: <http://www.pangalit.ee/eng/Info/>

The Scandinavian-owned Estonian banking system is modern and efficient, encompassing the strongest and best-regulated banks in the region. These provide both domestic and international services (including Internet and telephone banking) at very competitive rates. Both local and international firms provide a full range of financial, insurance, accounting, and legal services. Estonia has a highly advanced Internet banking system: more than 80 per cent of residents make their everyday transactions via Internet banking.

The Central Bank and the government hold no shares in the banking sector.

In 2001, the Estonian government created a consolidated Financial Supervisory Authority (FSA) under the auspices of the Central Bank. The Authority is an agency with autonomous competence and a separate budget. The FSA conducts financial supervision on behalf of the state and is independent in the conduct of financial supervision. The Authority was established to enhance the stability, reliability, transparency, and efficiency of the financial sector, to reduce system risks, and to prevent the use of the financial sector for criminal purposes.

A.10. Political violence

Politically motivated damage to projects or installations is extremely rare. However, in April 2007, following the government's decision to relocate a Soviet-era statue from downtown Tallinn to a nearby cemetery, there were two days of rioting and looting of shops in Tallinn. A subsequent Russian Federation boycott of Estonian goods, and disruption of rail and truck transit into Estonia had a negative impact on some local companies. For a few days in early May, cyber criminals targeted Estonian banks and government websites with massive denial-of-service (DOS) attacks, which cost several million Euros in estimated lost revenues. The industrial sector most impacted was transit. Initial data from the Port of Tallinn indicate they handled 20 percent less volume in 2008 than in the previous year. (The government has estimated the overall economic loss to Estonia of Russian restrictions on trade during May-December 2007 as between one-half and one percent of GDP.)

A.11. a. Corruption

Estonia has laws, regulations, and penalties to combat corruption and, while corruption is not unknown, it has generally not been a major problem faced by foreign investors. However, foreign companies have found it difficult to become part of the local commercial community because many Estonian executives have known one another since childhood and often help one another out in ways that make it difficult for outsiders to compete effectively.

Both offering and taking bribes are criminal offenses which can bring imprisonment of up to five

years. While 'payments' that exceed the services rendered are not unknown, and 'conflict of interest' is not a well-understood issue, surveys of American and other non-Estonian businesses have shown the issues of corruption and/or protection rackets are not a major concern for these companies.

In 2004, the government of former Prime Minister Juhhan Parts, who ran on an anti-corruption platform in 2003, instituted the 'Honest State' program, which included specific policies to reduce the risk of corruption in government. These included auditing local governments (widely seen as the greatest source of corruption in Estonia), requiring public servants to file electronic declarations of their economic interests, setting up a National Ethics Council, increasing the number of specialized investigators and prosecutors who focus on corruption, and setting up an anonymous hotline for people to report corruption cases.

The Security Police Board has shown its capacity to deal with corruption offences and criminal misconduct, leading to the conviction of several high-ranking state officials. Estonia co-operates in fighting corruption at the international level and is a member of GRECO (Group of States Against Corruption).

Estonia began as a full participant in the OECD Working Group on Bribery in International Business Transactions (the Working Group) in June 2004, and deposited its instruments of accession on November 23, 2004. The Convention entered into force in Estonia on January 22, 2005.

In 2007, Transparency International (TI) ranked Estonia 28th out of 180 countries on its Corruption Perceptions Index. The Estonian Ministry of Justice invited TI to take a lead role in the drafting of the country's new anti-corruption strategy.

A.12. Bilateral Investment Agreements

Estonia has investment promotion and protection agreements with the Belgium-Luxembourg Economic Union, China, Czech Republic, Denmark, Finland, Great Britain and Northern Ireland, Greece, Israel, Italy, Latvia, Lithuania, Netherlands, Norway, Poland, Spain, Sweden, Switzerland, Turkey, Ukraine, UK and the United States. A Bilateral Taxation Treaty with the U.S. came into force on January 1, 2000.

A.13. OPIC and Other Investment Insurance Programs

Estonia is a member of the Multilateral Investment Guarantee Agency.

Estonia joined the Exchange Rate Mechanism II on June 28, 2004. The Estonian kroon is fixed against the euro at 1 EUR = 15.6466 EEK. The Estonian banking and financial sector are judged generally stable, though they have endured stresses during the global credit crisis of 2008. Devaluation of the local currency in next year is unlikely unless major, unforeseen economic events occur.

A.14. Labor

Estonia has a very small population - only 1.4 million people. The Estonian labor force is highly skilled and well educated. There are 14 universities, 19 higher education colleges and 114 technical secondary institutions, all combining to produce graduates with adequate technical skills, and fluent in English, Russian, German and other languages. Over 17 percent of the population has

received post-secondary education; this number is growing rapidly.

The average monthly Estonian salary at the end of 2008 was USD 1,100. Annual economic growth above ten percent in recent years, rising inflation, and free movement of labor to other EU countries have driven up salaries in most sectors. Average gross wage growth in 2007 was 20 percent, and the increase for 2008 is expected to be approximately 14 percent and only around 5 percent in 2009.

The influence of trade unions, which tend to take a cooperative approach to industrial relations, is increasing. Estonia adheres to ILO Conventions protecting workers' rights.

With an aging population and a negative birth rate, Estonia, like many other countries of Central and Eastern Europe, faces serious demographic challenges affecting its long term supply of labor. Improving labor efficiency is a key focus for Estonia in the short-to-mid term. It is becoming increasingly hard to find a pool of blue collar workers to start up small or medium-sized manufacturing enterprises that requiring significant manpower.

A.15. Foreign Trade Zones/Free Ports

According to the Customs Act, free zones can be established on the customs territory by order of the government. Goods in a free zone are considered as being outside the customs territory, for the purposes of import and export duties. As a rule, customs procedures are not applied to goods in a free zone. In free zones, VAT and excise duties (as well as possible fees for customs services) do not have to be paid on goods brought in for later re-export.

In Estonia, there are free zones at the Muuga port (near Tallinn), the Sillamae port (northeast Estonia), and in Valga (southern Estonia). All free zones are open for FDI.

The main supervisory authority responsible for monitoring the movement of goods in or out of free zones is the Estonian Tax and Customs Board (governed by the Ministry of Finance). There are ID requirements for companies and individuals using the zone. The U.S. Department of Homeland Security (Coast Guard) has inspected Estonia's ports and determined that the Republic of Estonia has substantially implemented the International Ship and Port Facility Security (ISPS) Code at all facilities visited.

A.16. Foreign Direct Investment Statistics

By the end of Q3 2008, the cumulative stock of FDI amounted to USD 17 billion. Roughly 30 percent of FDI has been invested into financial intermediation and the same amount in real estate, renting and business activities. Manufacturing is in third place with 14 percent of total FDI. Wholesale and retail trade has attracted 13 percent of the foreign direct investment stock.

Scandinavian countries are the largest foreign direct investors in Estonia. Sweden has 39 percent of the total, followed by Finland with 25 percent, and the Netherlands with 6 percent. The United States accounts for 1.4 percent of foreign direct investment stock. (10th overall)

For the value of FDI (position, stock, and flows in recent years by the commodity group, as well as country of origin) please go to:

http://www.eestipank.info/pub/en/dokumendid/s_tatistika/maksebilanss/statistika/statistika.html?ob_jId=292616

The ten selected largest FDI companies in Estonia in terms of total investment:

11. Hansapank AS

Foreign Shareholder: Swedbank
Country of origin: Sweden
Sector of operation: banking

12. Sampo Bank

Foreign Shareholder: Danske bank
Country of origin: Denmark
Sector of operation: banking

13. Estonian Telecom

Foreign Shareholder: Baltic Tele AB
Country of origin: Sweden
Sector of operation: telecommunication

14. Eurodek Tallinn OU

Foreign Shareholder: Blanin Holding Ltd.
Country of origin: Netherlands
Sector of operation: transportation

15. SEB Pank AS

Foreign Shareholder: SEB AB
Country of origin: Sweden
Sector of operation: banking

16. Kandur AS

Foreign Shareholder: Kone Holland B.V.
Country of origin: Netherlands
Sector of operation: elevators, escalators

17. Rakvere Lihakombinaat

Foreign Shareholder: HKSCAN OYJ
Country of origin: Finland
Sector of operation: food industry

18. Kunda Nordic Cement AS

Foreign Shareholder: Heidelberg Cement AB/ CRH Europe Holding BV
Country of origin: Sweden/Netherlands
Sector of operation: cement production

19. Eesti Merelaevandus AS

Foreign Shareholder: Tschudi Shipping Company AS
Country of origin: Norway
Sector of operation: water transport

110. Phoenix Land AS

Foreign Shareholder: EBRD/Mellon ABN Treaty Omnibus/Tolaram Corp.Pte.Ltd.
Country of origin: UK/USA/Singapore
Sector of operation: textiles

PHILLIPS